

OGC Has Reviewed

25 October 1954

MEMORANDUM FOR: Special Tax File

SUBJECT : Overpayment of Tax resulting from Refund of Lump-Sum
Leave Settlement

1. On numerous occasions we have encountered the situation where an employee receives a lump-sum leave settlement in one tax year and refunds it to the Agency in the following. This would result in an excessive payment of tax in the year of receipt, and, if claimed as an itemized deduction in the year of refund, it would preclude the use of the standard deduction. This, in most cases, would work to the taxpayer's prejudice.

2. The normal rule established in the North American Oil Company case (see 542 CCH, Vol. II, para. 398.26) provides that where income is received under a claim of right, it is income for the year of receipt, notwithstanding the fact that the taxpayer may later be required to make a refund. The tax correction would normally be accomplished by taking an itemized deduction in the year of refund.

3. The inequity of this approach with regard to our personnel was discussed with representatives of the Internal Revenue Service (Mr. Forrest Neal, Deputy Chief, Audit, who later discussed it with Mr. Norman Sugarman, Assistant Commissioner, Technical) and they informed us that the so-called "claim of right" rule would not be considered applicable to our people since the lump-sum payment was, in effect, impressed with a trust. Accordingly, the correction in taxable income should be made by an amended return adjusting the gross income in the year of receipt.

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Office of General Counsel

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